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SUBJECT: NICARAGUAN BUSINESS SECTOR CAUTIOUS IN 2008

Classified By: Amb. Paul Trivelli for reasons 1.4 b&d.

11. (C) Summary: During their January 31 meeting, participants in the Ambassador's Economic Roundtable continued to paint a cautious outlook for Nicaragua's economy in 2008. In particular they highlighted the GON's unwillingness to address inflation, which reached 16.8% in 2007. While recognizing that international oil and domestic food prices played a role in inflation, roundtable participants cited other factors and proposed monetary and fiscal measures to address the situation. They expressed serious concern over the possible inflationary effects of Venezuelan assistance and the lack of transparency with which it is handled. Participants also discussed road blocks to Nicaragua's ability to take full advantage of CAFTA, highlighting the lack of engagement by the GON in trade capacity building for local producers. For a full list of roundtable participants, see Paragraph 10. End Summary.

Inflation Worries

12. (C) Overall, the participants in the Ambassador's Economic Roundtable presented a cautious outlook for Nicaragua's economy in 2008. They view the country's 16.8% inflation rate for 2007 as the most important drag on growth. While many agreed with the GON's position that external supply shocks in the form of high oil and food commodity prices are key components of this inflation, they all agreed that this does not excuse the government from carrying out monetary and fiscal policies to try to limit the effects. Roundtable economists noted that the October floods affected harvests causing food shortages for a time. They also highlighted several demand driven domestic components to Nicaragua's inflation among them the unchecked three-fold increase in M1 since 2006, the lowering of the Central Bank's prudential reserve rate for private banks by three percentage points in September 2007; and the 36% increase in the minimum wage. They also blamed the GON's decision to discontinue the "enhanced seed" distribution program for falling agricultural production and reduced food stocks.

13. (C) Roundtable participants were particularly worried about the GON's lack of a clear policy response to the inflation and its desire instead to engage in expansionary measures. They highlighted the GON's stated desire to spend an additional USD 120 million on social programs under the Poverty Reduction and Growth Facility, as such spending could have serious inflationary effects. They believe if the GON

does not re-launch a seed distribution program crop yields may not rebound in 2008 and food prices will continue to rise. Such price rises are particularly dangerous, according to some participants, because of President Ortega's personal, curious belief that high food prices are the result of Nicaragua's export of its foodstuffs. They worry that Ortega will eventually seek to control prices and limit exports to ensure national "food security."

14. (C) Participants proposed monetary and fiscal measures to reduce inflation and increase economic growth. Monetary policy proposals included conducting open market operations, sending clear messages to demonstrate the GON's commitment to reduce inflation, and re-evaluating the current 5% annual devaluation (crawling peg). Fiscal policy proposals included reviving the seed distribution program, increasing spending on economic infrastructure projects, and improving the investment climate to encourage foreign investment. One economist also pointed out that the Central Bank needs to change the way it forecasts inflation, because it has rarely hit the mark.

Effects of Venezuelan Money

15. (C) The unknown factor in Nicaragua's inflation is the role of Venezuelan assistance to be provided through an oil import scheme. While President Ortega has asserted in the press that Venezuelan assistance totaled USD 386 million in 2007, the lack of transparency on the origin and use of this money concerned the participants, who fear that the government will spend the funds on initiatives that are inflationary and do not encourage long-term growth. Participants agreed that the private sector needs to publicly insist on transparency for the USD 300-500 million expected to enter Nicaragua through the oil import scheme. (Note: While this number is speculative, it has been frequently bandied about in the press and by the Roundtable. End note.)

There are some bright spots and some concerns

16. (C) Despite these gloomy predictions for 2008, participants did point out several bright spots. Retailers reported double digit growth in 2007 and a stronger January in 2008 than in 2007. In their view, the sustainability of these numbers will depend on the length and depth of the U.S. economic downturn and its effect on Nicaraguan exports. The construction sector is picking up, benefiting both from a rise in home construction and in GON capital spending. Strong prices for agricultural products are increasing incomes for rural producers and driving them toward formal financial institutions. Interestingly, all participants felt remittances would not be greatly affected by the U.S. economic slowdown, citing studies that indicate remittances are not tied to the business cycle. (Note: 2007 remittances were USD 739.5 million, 6% above 2006. End Note.)

17. (C) However, clouds on the horizon include the closure of a number of apparel factories, the continued deterioration of the investment climate, and the corruption and politization of the judicial system. The apparel plant closures are particularly worrisome as Nicaragua has not developed diversity and strength in light manufacturing to absorb the loss. (Note: Participants attributed the plant closures to increases in the minimum wage, Chinese competition, and increased regulatory difficulties with the Ministries of Labor and Environment. End Note.)

CAFTA) Still a ways to go

18. (C) For roundtable participants, much still needs to be done in Nicaragua and the rest of Central America to take full advantage of CAFTA. Problems affecting all CAFTA countries include rigidities in labor markets and regulatory environments; lack of governmental skills in conducting trade capacity building; too few opportunities for producers to

learn basics such as packaging, labeling and SPS requirements; and the time and resources required to educate the population on CAFTA regulations. Participants noted that throughout the region, fear of possible negative effects of the agreement has subsided significantly. Anti-trade rhetoric in the U.S. presidential campaign, however, is slowing down new investment that would take advantage of the agreement.

¶9. (C) Barriers to taking advantage of CAFTA in Nicaragua center on the lack of GON actions to support the agreement. Participants noted that Ortega is clearly more interested in promoting ALBA over CAFTA; as a result the National Assembly has not taken-up legislation that would improve the private sector's ability to take advantage of trade agreements. The Ministry of Trade, Industry, and Development, the natural lead on CAFTA promotion, has been focused on free trade negotiations with the EU and showing that there is value in Nicaragua's ALBA agreements. The slow-down in trade capacity building programs by donors has also limited the further diversification of Nicaragua's export base. Participants believe that trade with the United States will grow more slowly this year than in the previous three years.

¶10. (C) Nicaraguan Private Sector Participants:

Mario ALONSO, Former President of the Central Bank

Mario ARANA, Executive Director FUNIDES (Local economic think-tank), Former President of the Central Bank, Lead CAFTA negotiator

Luciano ASTORGA, General Manager, General Manager BAC Nicaragua (Owned by GE Financial)

Julio CARDENAS, Executive Director) Bancentro (U.S.-citizen owned bank)

Alberto CHAMORRO, President, E. Chamorro Commercial and Director, BAC Nicaragua (Owned by GE Financial)

Joaquim DE MAGALHAES, General Manager, Esso Nicaragua

Erwin KRUGER, President DRACMA (Economic Magazine), business leader and economist.

Alejandro MARTINEZ Cuenca, President) International Foundation for Global Economic Challenge (Economist, businessman, FSLN member, Economy Minister in 1980s)

Eduardo MONTIEL, Professor, INCAE Business School. TRIVELLI